MEMORANDUM FOR: THE RECORD

The attached memorandum, which provides comments on a draft OECD paper on East-West trade, was requested by Mr. James Libera, EUR/RPE, Department of State. The OECD draft was being tabled for consideration in meetings of the Secretariat on 7 and 8 March. [redacted] 25X1

Chief
Trade Branch
Soviet Economy Division
Office of Soviet Analysis

Date 15 March 1983

FORM 5-75 101 USE PREVIOUS EDITIONS

Distribution: SOV M 83-10053/EURM-83-10099

Original & 1 - Addressee
1 - D/SOVA
1 - DD/SOVA
1 - DC/PES
1 - DDI Action Staff
1 - ED/DCI
1 - NIO/Economics
1 - SA/IA/DCI
1 - SOVA/SE/D
1 - SOVA/PS
1 - SOVA/ES
1 - SOVA/CS/D
1 - SOVA/DI/D
5 - CPAS/IMC/CB
1 - SOVA/SE/T

SOVA/SE/[redacted] (15 March 83) 25X1

(1)

3 March 1983

Comments on OECD Secretariat Draft Paper on East-West Trade (TC (83) 3)

Both the Office of European Analysis and the Office of Soviet Analysis have reviewed the OECD draft. While the OECD paper represents a useful start in describing broad trends in East-West trade, our main concern is that it does not provide enough focus or analysis to help policymakers deal with this complex and contentious subject. What is needed in a future draft is a framework that would give direction to the statistical analysis contained in the paper.

The remaining portion of this memorandum contains some general comments on the paper, as well as some specific points that need to be corrected or further clarified.

General Comments:

-- Because the paper takes a global and highly aggregative approach to East-West trade, it misses key differences between the East European countries and the USSR. For example, although the paper alludes to differences in resource endowment, product content of trade flows, and the direction of trade, it presents no real discussion of what these differences are and what they imply for Bloc trade wtih the OECD.

-- The paper fails to assess in specific terms why East-West trade is important to both the East and West, despite the fact that it is a relatively small share of

most of the countries' total trade. It also needs to take a more detailed look at the question of interdependence between Eastern and Western Europe.

-- The paper fails to analyze how the East European countries got themselves into their current economic and financial situation or how they can be expected to deal with them beyond short term measures. Future options and prospects are not adequately assessed.

-- The paper does not explore the trade policy options that the OECD countries could develop either in dealing with Eastern Europe (differentiated from the USSR) or with the USSR alone. The issue of a differentiated strategy vis-a-vis Eastern Europe is not considered.

-- Insufficient attention is given to the linkage between credits and trade and between developments in the domestic sectors of all these economies and their trade performance and policy. Indeed, except for a few fleeting references to financial issues at the end of the paper, credit matters are largely ignored.

-- While the paper points to a boost in intra-CEMA trade and trade with LDCs as options for the East European Six (as they now face a net resource outflow to the West), not enough evidence or analysis is presented on the viability of such options and what they imply for East-

Specific Comments:

-- Para 3. The fact that Eastern Europe increased imports of agricultural commodities and industrial raw materials after 1975 as well as imports of machinery is ignored.

-- Para 8. The statement that Poland is still "the OECD's second most important partner among the East European countries" is questionable, especially if inner-German trade is included, most notably for 1981 and 1982.

-- Para 9. The draft says that "there were especially important monetary effects during 1981" without stating what they were or why they were important. More information on this point should be presented, as well as some discussion on their relationship to trade flows. The paragraph also fails to consider that East European Six trade with the LDCs starts from a very low base. Therefore, even modest increases will be large in percentage terms.

-- Para 10. The draft does not consider the role of government export credit subsidies in the sales of certain key commodities in East-West trade. Canada, Japan, and the USSR have all subsidized their exports, whereas USG support of its grain sales has been minimal or nonexistent. Sales to Poland and to a limited degree to Hungary have been modest exceptions through the CCC programs.

-- Para 14. In the case of the USSR, all of the shift toward oil was the result of increased prices, i.e., the

CONFIDENTIAL

4

volume of oil exports to all hard currency countries did not increase any faster than the volume of non-oil exports. Thus, in constant dollars, the share of oil in total exports was about 17 percent in both 1970 and 1980.

-- Para 16. The data on Soviet oil exports in 1981 and 1982 included trade with Belgium only for the first quarter of the year, whereas the data for earlier years include Belgium without interruption. Moreover, the total reported for the first nine months of 1982 (49.3 million metric tons) differs from our estimate of 47.9 million tons, which was based on published OECD data for January through June supplemented through the third quarter with information which the Energy Department supplied to us from the IEA.

-- Para 17. The USSR does pay transit fees to Czechoslovakia.

-- Para 18. In the case of the USSR, the greatly increased need for agricultural imports due to poor harvests led Moscow to reduce imports of machinery and equipment. Also, note that Soviet imports of Western machinery and equipment have been declining in real terms since 1976.

-- Paras 18-20. The draft describes shifts in the commodity composition of East European trade but doesn't discuss why this occurred in terms of either the

-- Para 21. East European energy conservation policies should be addressed--particularly with reference to Hungary and the GDR, where some success has been achieved.

-- Para 23. We believe that in discussing the potential for Soviet exports of natural gas a closer look needs to be given to the likely level of Western demand, especially in view of weakening oil prices.

25X1

[redacted] please add the following at the end of the paragraph: "Moreover, as much as one-fifth of annual crop production is lost as a result of the lack of transportation and equipment for timely harvesting, storage, and processing of farm products."

-- Para 26. [redacted] 25X1

25X1

Such a low forecast for grain imports implies either (1) much larger average grain crops than we see likely or (2) much lower meat production than we believe the regime can accept. We think that average Soviet imports will approach 30 mmt in the last half of the 1980s.

[redacted] 25X1

-- Para 28. We suggest substituting the following paragraph: "Greater self-sufficiency is not a new goal of East European agricultural policies; it was pursued in the past in connection with attempts to boost domestic production. In the present economic and financial squeeze, the East Europeans are also trying to achieve self-sufficiency by reducing consumption of livestock products, particularly meat. Prices of major food products, and particularly those of meat and other livestock products, have been raised in almost all East European countries in an attempt to dampen demand. This seems likely to have an appreciable effect on demand. The level of meat consumption is expected to increase on average only marginally; it is expected to fall in Poland and Czechoslovakia."

-- Para 29. Reductions in grain import levels by East European countries are based on political as well as economic considerations. Consumer reaction to the lack of food availability could have serious political implications.

-- Para 30. Do you mean 20-30 million tons over the five year period? Since the increase in world grain trade over the last decade responded in large part to the Soviet and East European market, even a small decline in

-- Para 40. The draft notes that Eastern Europe and the European OECD countries have lost ground in East-West trade because their mutual trade is concentrated to a greater extent in industrial goods, but does not give an adequate explanation for this slippage. Western recession has been a contributing factor, as well as Eastern Europe's decision to cut capital goods imports. Since these elements provide a clear illustration of economic interdependence, they should be highlighted in the analysis.

-- Para 44. The statement about the banking community not wishing to increase its exposure may not be true in the case of the USSR as long as the credits are used to support the exports of customers of Western banks.

-- Para 44. According to the draft, "international financial institutions (IMF, BIS) have recently had to step in to provide bridging loans to the more exposed Eastern countries". Only Hungary and Romania are eligible for IMF assistance, and the BIS has provided assistance only to Hungary.

-- Para 45. We assume that the draft is talking about a credit squeeze on Western government-backed credits, since this is the type of credit mainly used to finance turnkey projects and major equipment deals. The idea of a squeeze on such credits does not, however, appear to be consistent with the thoughts expressed later in the same paragraph. Doesn't intensified competition among

Western exporters and even greater backing on part the of Western governments imply increased competition in credit offerings?

-- Para 47. The USSR is also in the process of firming up sizable contracts for the Astrakhan sour gas project and is considering other gas projects.

-- Para 48. On the other hand, the world price of oil could decline even further. Each drop of $1 a barrel in the price of oil would result in a roughly $450 million decline in the value of hard currency revenue.

-- Para 50. The draft fails to point out that the GDR registered a surplus in its trade with the OECD in 1982, nor does it indicate that Czechoslovak economic stagnation is a long-term phenomenon predating 1981 and 1982.

-- Para 51. The current economic recession has complicated Eastern Europe's effort to increase exports to the OECD.

-- Para 53. A large part of the shift--at least in the case of the USSR--in the composition of East European debt away from commercial borrowing was due to a policy of suppressing imports in order to keep borrowing down.

-- Para 54. The draft does not take into account the current account surpluses achieved by all of the East European countries but Poland and Hungary in 1982. The reference to "intra-CEMA lending by the Soviet Union" as an alternative means of financing is questionable. We have seen no evidence of new hard currency lending to

#333

Eastern Europe by Soviet banks. In fact, Hungary has complained that CEMA banks withdrew funds last year.

-- Para 54. Does the $24 billion in East European debt maturing in 1982 include short-term debt? Does it include interest payments falling due?